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By Tiffany Kary and Laura J. Keller
(Bloomberg) -- A bubble in the leveraged-finance market is
growing and may burst in 12 to 18 months, said Edward Altman, a
specialist in credit markets who developed a model for
predicting corporate bankruptcies.
“We think it’s building,” Altman told a gathering of
corporate restructuring experts Wednesday in New York. He said
the current “benign credit cycle” encouraged by low interest
rates has been going on for five years and led to a “frothy”
market. “You’ll be busier at this time next year.”
A financial crisis isn’t necessarily expected, since few
economists are also predicting a U.S. economic recession, Altman
told the Turnaround Management Association, a group of
consultants, lawyers, liquidators and other professionals who
advise distressed companies.
     Altman is the director of research in credit and debt
markets at New York University’s Salomon Center for the Study of
Financial Institutions. He developed the “Z-Score,” a method
of predicting a company’s likelihood of bankruptcy.
The riskier a company, the more it pays in borrowing costs
because lenders and bond investors demand higher interest to
compensate for greater default probabilities.
Altman predicted the default rate will climb to around 3.3
percent in 2015 from 2.1 percent because the cost of debt
capital has risen and the number of companies trading at
distressed levels doubled last year. Already this year, the
default rate is 0.85 percent, with the bankruptcy filing of the
main operating unit of Caesars Entertainment Corp., Altman said.

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Increased regulatory scrutiny of underwriting standards has
been predicted by some to hold down leveraged loan issuance this
year. Companies last year issued $507.9 billion of U.S. loans
sold to institutional investors, down from a record $684 billion
in 2013, according to data compiled by Bloomberg.
Energy Future Holdings Corp., which filed the biggest U.S.
bankruptcy of 2014, accounted for half of last year’s rate, he
said. He said he expects the number of big bankruptcy filings to
rise this year while staying below historic averages.
He said his predictions about the credit markets are based
on quantitative factors such as the ratios of debt to earnings,
and don’t factor in qualitative factors such as rising oil
prices or geopolitical events.
Altman identified several possible catalysts for a jump in
the default rate -- less access to credit and continued drops in
commodity prices chief among them. Energy producers who issued
new bonds and took out loans while borrowing costs were low have
since been hit with plunging oil prices.
Central banks will eventually have to account for easy-
money policies, he said. “At some point, they’ll have to back
up because of their own balance sheets or the lack of success.”
The last time Altman predicted a bubble was in 2007,
shortly before the financial crisis. At the time, the debt-to-
earnings ratio by one measure had peaked at 6.2 in the U.S. Last
year, that number was 5.8.

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